carriers were able to establish coordinated strategies over that period in place of competition"[38] and that "[t]heir coordination takes levels of price-cost margins toward higher levels than would result from independent price setting."[39] As he explained:

> For findings of increased competitiveness, margins should have decreased when concentration declined, or when concentration reached and then stabilized at levels below those associated with the presence of second or third equal-sized sources of service. But that did not take place in the ten years since industry restructuring. To the contrary, margins have increased, particularly during and after concentration stabilized at those lower levels. Reduced competitiveness has been the result.[40]

Notably, this "reversal of the structure-performance relationship" – that is, the finding that price-cost margins increased rather than decreased as concentration declined – "took place in message toll and all the business service markets nationally."[41]

Further confirmation of this point comes from Professor Jerry Hausman, who has found that AT&T, MCI, and Sprint have engaged in "lock step price increases in long distance" while "the largest cost component, long distance access, has decreased significantly over the same time period."[42] Professor Hausman noted that:

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38 P. MacAvoy, THE FAILURE OF ANTITRUST 172. MacAvoy is the Williams Brothers Professor of Management Studies (and past Dean) of the Yale School of Organization and Management. His analysis is presented in depth in Chapters 4 and 5 (pages 83-174) of his book.

39 *Id.* at 156.

40 *Id.* at 173-74.

41 *Id.* at 171.

42 Declaration of Professor Jerry A. Hausman in Support of BellSouth's Section 271 Application for South Carolina, filed Sept. 30, 1997, at ¶ 30. Hausman is the MacDonald Professor of Economics at MIT.

> [T]wo major cost components of long distance service – access and transport – have both decreased significantly over the past few years, yet residential long distance prices have not reflected those price decreases. This outcome is another indication of non-competitive behavior.[43]

Notably, the conclusion reached by these economists is shared by Wall Street. In a recent analysis of AT&T, Merrill Lynch explained that AT&T had not passed through the full extent of the July 1997 access charge reductions:

> We estimate AT&T received a total annualized access cut of $800M, on July 1. About $400M was passed through to business customers in rate cuts beginning last December (in anticipation of the July 1 order). AT&T had assured the FCC that the remaining $400M would be passed through to consumers in the form of basic rate reductions. However, we estimate that only $65M (annualized to $250M) was passed on to consumers in 3Q. *The result was higher consumer prices and AT&T profits, which we expect will continue into both 4Q and '98.*[44]

Clearly, if the market truly were competitive, no carrier would be able to keep these savings as profits rather than passing them to consumers in the form of lower prices.

b) The Merger Would Reverse WorldCom's Incentives to Disrupt the Oligopoly and Would Exacerbate Coordinated Interaction Among the Remaining IXCs.

The merger of WorldCom and MCI would diminish long distance competition for four reasons: (1) it would reverse WorldCom's incentive to act as a maverick, because continued aggressive pricing by WorldCom would undercut profit margins from its newly acquired customer base; (2) it would reduce the number of significant competitors from four to three and otherwise aggravate the tendency toward coordinated interaction; (3)

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43 *Id.*

44 Merrill Lynch, AT&T Corp. 3d Quarter Review (Oct. 21, 1997), at 2 (emphasis added).

it would place the vast majority of long distance capacity under the control of a small group of players, so that the threat of "mutually assured destruction" would deter real price competition; and (4) it would appreciably reduce the market share gap between the top two competitors, which would further discourage competitive pricing.

The merger would eliminate the only significant "maverick" competitor. WorldCom traditionally has undercut the AT&T/MCI/Sprint coordinated price. Indeed, GTE's own experience as a consumer of long distance services is that WorldCom has been far more price-competitive than its larger rivals.[45] This experience apparently has been shared by many customers: "Over the years, the long-distance companies say WorldCom's aggressive tactics have forced them to cut prices – especially with business customers, an MCI niche. But the merger knocks WorldCom out as a competitor."[46]

After the merger, WorldCom's incentives, and therefore its market behavior, will shift by 180 degrees. Currently, as a firm with low retail market share, WorldCom does not lose much profit from its existing customers when it lowers prices because it has relatively few customers. Thus, it gains more by attracting new customers through reduced prices (even at reduced margins) than it loses from current customers. After the merger, in contrast, WorldCom will no longer be the brash upstart hungry for market share. Rather, it will be anxious to preserve and protect the value of its acquisition. At

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45 *See* Declaration of Debra R. Covey.

46 Glassman, *"Dial M for Megamerger, The MCI-WorldCom Deal May Not Be So Good For Consumers,"* U.S. News and World Report, Nov. 24, 1997, at 68 ("*Glassman article*").

a minimum, continued aggressive pricing would cannibalize the combined company's own customer base (by enabling existing MCI customers to take service at lower rates), without earning sufficient revenues from new customers to offset these losses. It would be irrational for WorldCom to invite, and for the Commission to expect, such a scenario.

The risk of significant price increases by the combined MCI/WorldCom is particularly great because the two companies are strong in the same market segments, suggesting that many customers view them as their first and second choices. As Carl Shapiro (past Deputy Assistant Attorney General for Economics in the Antitrust Division) explains:

> If a significant proportion of consumers considers the merging firms' products to be their first and second choices (at premerger prices), then the merged entity will have an incentive to impose a non-trivial price increase following the merger.[47]

The amount of this increase is likely to be greater where there are "high Gross Margins and high Diversion Ratios."[48] As Crandall, Waverman, MacAvoy, and Hausman have shown, the long distance market certainly is characterized by high gross margins. And, while MCI and WorldCom provide no data on the diversion ratio – that is, the proportion of customers who would leave one carrier for the other in response to a price increase by the first – the fact that these suppliers are particularly strong in the same market segments implies that this ratio is high.

Finally, Shapiro cautions that accommodating responses by rivals to a post-merger price increase are likely to result in even higher overall prices in the market:

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47 Shapiro, "Mergers with Differentiated Products," Antitrust (Spring 1996) at 24.

48 *Id.* at 26.

> Game-theoretic analyses of pricing competition with differentiated products indicate that rivals will typically find it optimal to raise their prices in response to higher prices set by the merging firms. Accounting for these accommodating responses tends to increase, not decrease, the predicted post-merger price increase.[49]

That is, AT&T and Sprint are likely to accommodate price increases by raising their own rates, rather than aggressively responding. Consequently, there is every reason to expect that the WorldCom/MCI merger would restrain rather than promote competition in the domestic retail long distance market.

<u>The merger would facilitate coordination by substantially increasing concentration in the market</u>. By increasing consolidation in the already highly concentrated long distance market, the merger would reinforce the structural conditions that underlie existing non-competitive pricing. Cooperation would be significantly easier with only three, rather than four, most significant market participants. Moreover, the remaining competitors would be far better able to police non-cooperative pricing. Today, WorldCom essentially serves the mass market by distributing its services through many resellers, each of which makes its own pricing decisions. After the merger, as discussed in Section II.B below, WorldCom will have an incentive to increase its wholesale rates and leave resellers even less margin to undercut the prices set by the Big 3.

<u>The merger would deter competitive pricing by giving three companies control of the vast majority of long distance capacity</u>. Because the three remaining major competitors would control so much capacity, the merger would further entrench the

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49 *Id.* at 27.

conditions giving rise to non-competitive pricing. In the past, the Commission has concluded that excess capacity can be used to discipline uneconomically high prices, and it relied on this analysis in re-classifying AT&T as a non-dominant carrier.[50] Excess capacity is a two-edged sword, however. Where, as in today's long distance market, a few competitors enjoy both substantial amounts of reserve capacity and relatively even market shares, it can cut against competitive pricing. Indeed, economists have long recognized that continued excess capacity can serve as a deterrent to new entry or price-cutting by signalling that retaliation will be a low-cost, rational, and credible strategy.[51] That is, each incumbent holds a "club" over the others and over prospective new competitors – in essence, mutually assured destruction – that keeps both entry and a price war at bay. The merger would give the remaining AT&T, WorldCom/MCI, and Sprint even bigger clubs; since virtually all of the nationwide capacity would be controlled by the cartel, the prospect of truly competitive pricing would be even more remote.

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[50] *AT&T Non-Dominance Order*, 11 FCC Rcd at 3303-05. The applicants have provided no information regarding capacity in the long distance market, and GTE believes that there may be areas of the country where capacity may be limited. In such areas, the deterrence effect from regions where excess capacity is in place may still prevent both more competitive pricing and additional investment in facilities.

[51] J. Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION, Chapter 8 (MIT Press 1989). *See also* P. MacAvoy, THE FAILURE OF ANTITRUST 102 (excess capacity among the largest IXCs "provided each carrier with more incentive to choose price levels that limit incursions in the revenue shares of each of the carriers in each of the key markets."); Crandall and Waverman Affidavit at ¶¶ 61-63.

The merger would deter competitive pricing by reducing the market share gap between AT&T and WorldCom/MCI. Economic theory shows that, as market shares in an oligopoly become more nearly equal, cooperative rather than competitive pricing is more likely to prevail. As explained in the leading text on market performance:

> [W]hen cost functions and/or market shares vary from firm to firm within an oligopolistic industry, conflicts arise that, unless resolved through formal collusive agreements, interfere with the maximization of collective monopoly profits. And if left unresolved, these conflicts may trigger myopic, aggressive behavior that drives the industry away from the joint profit-maximizing solution of its price-output problem.[52]

The merger of MCI and WorldCom would informally resolve the market share "conflicts" by equalizing market shares. Consequently, the combination of these companies would further deter the "myopic, aggressive behavior" that most benefits consumers. As Professor MacAvoy has concluded, "the more alike in size the companies get, the less they compete for market share," and consequently, the WorldCom/MCI merger is "very likely to facilitate collusion."[53]

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52 F. Scherer, INDUSTRIAL MARKET STRUCTURE AND ECONOMIC PERFORMANCE 160 (Houghton Mifflin, 2d ed. 1980). The same point is made by Professor MacAvoy in THE FAILURE OF ANTITRUST (at 100-101):

> When shares of the second and third largest firms increase to levels more comparable to if not the same as that of the largest firm, and regulation eliminates price floors for the largest firm, the second and third firms would not clearly be advantaged from further individual initiatives to increase their shares. With two to three equal-sized firms, any one can credibly threaten its rivals with large price reductions if those rivals seek to have shares further redistributed. ... It is more credible to expect that each firm sets out its own tariff, with the preconception that all firms will do the same, to maintain previous shares.

53 *Glassman article, supra* note 45, at 68.

B. The Merger Would Compromise the Supply of Bulk Capacity and Advanced Features in the Resale Input Market.

Product and geographic markets. As the Commission recognized in the *Bell Atlantic/NYNEX Order*, the competitive effects of a proposed merger must be assessed in both wholesale (input) and retail markets.[54] The wholesale long distance market consists of the supply of bulk capacity (either minutes of use or leased facilities) and advanced features (such as enhanced 800 service, frame relay, and Advanced Intelligent Network capabilities) to resellers. Like the retail market, the wholesale long distance market is composed of point-to-point geographic markets that may be aggregated where the same competitive conditions prevail, and of various customer groups. The applicants, once again, have failed to provide any information regarding market conditions either on particular routes or nationwide, and have failed to discuss the impact of the merger on specific reseller customer groups.

Most significant participants. The most significant market participants in the supply of wholesale capacity to long distance resellers are the same as in the domestic retail market – AT&T, MCI, Sprint, and WorldCom. While the applicants have provided no wholesale market share data, GTE believes that WorldCom has a far greater share of the wholesale market than of the retail market, and may even be the largest or second largest provider of such capacity. Whatever its share, WorldCom has aggressively pursued wholesale supply arrangements as a means of indirectly serving residential and small business customers. That is, recognizing that its own brand name is largely unrecognized in the retail mass market, WorldCom has followed a strategy of

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54 *Bell Atlantic/NYNEX Order* at ¶¶ 115-120.

distributing its services through resellers with known brands, such as GTE, Ameritech, and Excel.

In contrast, the other large IXCs have brands with more appeal in the mass market, and they generate large profit margins by directly serving residential and small business customers. Their profit margins from wholesale services are far lower, making the wholesale market a much less attractive distribution mechanism for them than for WorldCom. Put another way, AT&T, MCI, and Sprint incur an opportunity cost when they sell wholesale service or capacity to a reseller.[55] If resellers aggregate traffic from residential and small business customers, from whom retail toll margins are significant, then the opportunity cost associated with resale is quite large. Consequently, existing competition by the Big 3 long distance carriers in the wholesale market, limited though it may be, almost certainly is due to the presence of a competitor (WorldCom) that does not directly serve mass market customers. Absent WorldCom, the Big 3 IXCs rationally would pursue an even less vigorous wholesale marketing strategy.

The belief that WorldCom is the leading supplier of wholesale long distance capacity and advanced features to resellers is bolstered by GTE's own experience. As detailed in the attached Declaration of Debra R. Covey, WorldCom has been more willing than the other large facilities-based IXCs to offer attractive rates and terms to resellers. In addition, although WorldCom traditionally was a "plain vanilla" provider of wholesale capacity, it has also committed to provide advanced features and capabilities

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[55] For example, if AT&T has half the retail market, then supplying a minute of wholesale service to a reseller would, on average, cost it roughly half the profit it would have earned from supplying a minute of retail service to the final consumer of the reseller.

to its wholesale customers – features that the three largest IXCs have been reluctant to provide to resellers. WorldCom has also agreed to develop additional features for resellers in the future.

These advanced capabilities are essential elements of the services that GTE and other carriers resell to business and residential customers. Without access to them on a nationwide basis, GTE would be seriously hampered in its resale efforts. Because of WorldCom's competitive pricing and responsiveness on non-price terms, GTE entered an agreement in 1996 under which WorldCom supplies a significant portion of GTE's domestic voice resale needs.

In contrast to WorldCom, the three largest facilities-based IXCs are far less accommodating of resellers. In GTE's experience, AT&T pursues a high-price strategy in the wholesale market that renders it a less competitive choice as a supplier. MCI and Sprint are somewhat more price-competitive than AT&T,[56] but none of these three carriers provides GTE the full range of advanced capabilities offered to their retail customers.

No other feasible sources of supply exist. Only the Big 4 IXCs can effectively compete to provide nationwide wholesale long distance capacity for resale. The remaining providers of wholesale capacity are generally regional suppliers that lack features desired by resellers, such as redundant or diverse routing and advanced network capabilities. Moreover, these smaller carriers have higher cost structures than the largest IXCs because they interconnect at relatively few local tandems and at few or

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[56] MCI was the second choice for GTE in the competition won by WorldCom.

no end offices. Any reseller using their networks must therefore obtain additional long-haul transport and (directly or indirectly) pay higher access charges.

Adverse competitive effects of the merger. The merger with MCI inevitably will alter WorldCom's incentives and practices in the wholesale market. Currently, WorldCom's comparative willingness to offer resellers favorable rates and advanced features can be ascribed to its small retail market share. In the pre-merger market, WorldCom often acts as a carrier's carrier, deriving a substantial percentage of its long distance revenues from the wholesale supply of bulk transport than from retail services. After the merger, in contrast, rather than welcoming resellers as a distribution channel, WorldCom will realize that increased sales through resellers would diminish its profit margins by cannibalizing MCI's lucrative retail customer base. That is, the opportunity costs of resale for WorldCom will increase to the point where resale is no longer a favored distribution strategy. GTE therefore expects that WorldCom will increase its wholesale rates, limit the range of advanced capabilities that it offers to resellers, and discontinue commitments to develop additional wholesale capabilities.

In short, the result of the merger, as in the retail market, will be the elimination of the "maverick" supplier and the promotion of cooperative rather than competitive pricing. Residential and small business customers will suffer because resellers will pay higher prices for wholesale capacity (an anticompetitive unilateral effect of the merger), which they will be forced to pass on through higher end user rates. Customers also will be hurt because resellers will be denied access to the advanced capabilities they need to compete. The merger thus will injure consumers both directly (by restraining retail competition) and indirectly (by hindering resale).

III. THE WORLDCOM/MCI MERGER WOULD CREATE MARKET POWER IN INTERNATIONAL TELECOMMUNICATIONS MARKETS.

WorldCom and MCI assert that the merger "will provide WorldCom with additional facilities and resources to accelerate its expansion into international markets now that international opportunities are increasing and WorldCom is beginning to compete with the large incumbent carriers to capture those opportunities."[57] The companies additionally conclude that the merger will trigger an avalanche of competitive benefits for international services without a single countervailing adverse effect.[58] Yet again, however, these assertions not only are unsupported by any facts, figures or analyses, but fail to explain why strengthening WorldCom at the expense of eliminating MCI as an independent competitor would not harm consumers.

WorldCom and MCI's failure to identify a single anti-competitive effect of their merger on the international markets is, at best, willful ignorance. Even the slightest attempt at such an analysis reveals significant potential harms to consumers and competition in international markets. When publicly available data are applied to rational market divisions – as GTE does below – the smoke screen clears and it is evident that the merger of WorldCom and MCI would undermine the Commission's pro-competitive international policies and substantially restrain international telecommunications competition.[59]

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57 WorldCom/MCI Application at 36, Vol. I.

58 *See* WorldCom/MCI Application at 27, Vol. I.

59 The Commission repeatedly has stated that the lack of competition in the U.S. international telecommunications marketplace has resulted in supra-competitive prices and restricted carrier entry. *See Rules and Policies on Foreign*

A. The WorldCom/MCI Merger Would Result In Increased Market Concentration In International End-User Product Markets.

The Commission has long held that there are two relevant international retail markets: international message telephone service ("IMTS") and non-IMTS (primarily private line) services.[60] This definitional split was borne of the FCC's conclusion that IMTS and private line services are not substitutable products.[61] As detailed below, the merger would stifle competition in both of these markets.

1. The WorldCom/MCI Merger Would Result in Increased Market Concentration in the International Private Line Services Market.

A merger of WorldCom and MCI would create the world's largest carrier in the international private line market, possessing dramatically enhanced market power in an already oligopolistic market. Publicly available data from 1996 demonstrate that the overall international private line services market is already highly concentrated, with an

(...Continued)
Participation in the U.S. Telecommunications Market, Report and Order, IB Docket No. 97-142, FCC 97-195 (rel. June 4, 1997); *Market Entry and Regulation of Foreign-Affiliated Entities*, 11 FCC Rcd 3873 (1995); *International Settlement Rates, Report and Order*, IB Docket No. 96-261, FCC 97-280 (rel. Aug. 18, 1997). To counteract this imbalance, the Commission has attempted to jump-start competition, for example, by opening the U.S. market to additional foreign participation. *See Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, Report and Order*, IB Docket No. 97-142, FCC 97-398 (rel. Nov. 26 1997), and by streamlining regulatory oversight of U.S. carriers. *See Streamlining the International Section 214 Authorization Process and Tariff Requirements, Report and Order*, 11 FCC Rcd 12884 (1996); *AT&T Non-Dominance Order*, 11 FCC Rcd 3271 (1995).

60 *See International Competitive Carriers Policies*, 102 F.C.C. 2d 812, 821-823 (1985), *recon. denied*, 60 R.R. 2d 1435 (1986).

61 *See id.*, 102 F.C.C. 2d at 824-826.

HHI of 2,757 (*see* Table 2).[62] In terms of revenues, MCI is ranked second and WorldCom is third; combining their revenues in this market will give the newly merged entity a 44.8 percent market share. This would leapfrog the merged company past the 39.8 percent share held by the current market leader, AT&T. As a result, the merger would increase the HHI by 921 points to 3,678 (*see* Table 3). Under federal merger guidelines, such an increase would lead the DOJ to presume the merger likely to create or enhance market power.

Table 2 - Pre-Merger International Private Line Market

AT&T	$261,473,067	39.8%
MCI	$189,554,148	28.9%
WorldCom	$104,654,355	15.9%
Sprint	$59,632,755	9.1%
All Others	$41,096,382	6.3%
World	$656,410,707	
Pre-Merger HHI		2,757

Table 3 - Post-Merger International Private Line Market

MCI/WorldCom	$294,208,503	44.8%
AT&T	$261,473,067	39.8%
Sprint	$59,632,755	9.1%
All Others	$41,096,382	6.3%
World	$656,410,707	
Post-Merger HHI		3,678
Increase in HHI		921

This HHI analysis demonstrates that the merger poses a serious competitive concern, which WorldCom and MCI simply ignore. Mere disregard for the facts, however, can not make them disappear: By combining the second- and third-ranked carriers in the private line market, the transaction will significantly increase

[62] Federal Communication Commission, *1995 Section 43.61 International Telecommunications Data* (Oct. 31, 1996).

concentration and hurt the public, including government entities that are consumers of these facilities, by eliminating competitors from the market.

The adverse effects of the merger are even more striking when examined on a route-specific basis, as is the Commission's longstanding practice in defining relevant geographic markets for international services.[63] An analysis of the 1995 data from these markets shows that a WorldCom/MCI merger would create private line service overlaps in 76 U.S. foreign markets worldwide. As the charts in Appendix 1 make clear, these markets span the globe and affect virtually every vital commercial center. The merger would be "likely to create or enhance market power" under the DOJ's merger guidelines in 71 of these 76 overlap markets.[64] Indeed, in 9 of these markets, the post-merger HHI would be 10,000, indicating pure monopoly conditions.

It is absurd to argue that the creation of anti-competitive and monopolistic conditions in private line markets around the world does not create public interest concerns. Quite clearly, the merger would deprive customers of a competitive market's greater variety of services and lower prices. While MCI and WorldCom might benefit from their combination, consumers most assuredly would not.[65]

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[63] *International Competitive Carrier Policies*, 102 F.C.C. 2d 812, 828 (1985).

[64] FCC 1995 Section 43.61 International Telecommunications Data (Feb. 1997).

[65] The anti-competitive effects of the proposed combination are not vitiated by the theoretical possibility that other carriers could route traffic for countries served primarily or exclusively by WorldCom/MCI via third countries. Carriers from many countries – particularly those that retain substantial state ownership or monopolies – are reluctant to substitute "transit" arrangements for international long-haul agreements because of reduced revenues. Even where a particular nation was willing to accept transit-routed U.S. traffic, it might be some time before other U.S. carriers could negotiate new foreign operating agreements.

2. The WorldCom/MCI Merger Would Threaten Competition in the International Message Telephone Service Market.

As with the international private line services market, a WorldCom/MCI merger would have a profoundly anti-competitive effect on the IMTS (U.S. originating or terminating) market. The proposed merger would result in the consolidation of the second largest (MCI) and fourth largest (WorldCom) competitors in this market. Even absent the merger, today's IMTS market is effectively an oligopoly of four carriers, which together account for over 98.3 percent of IMTS revenues (*see* Table 4). Were the Commission to approve the proposed merger, the market instantly would be dominated by just three players, to the detriment of consumers and new carrier entrants. Indeed, the overall effect of permitting the proposed merger would be an increase the HHI in the IMTS market from 4,450 to 4,954 (*see* Table 5). This 504-point increase is considered likely to create or enhance market power under the DOJ Merger Guidelines.

Table 4 - Pre-Merger International Message Toll Service

AT&T	$8,537,707,177	61.5%
MCI	$3,252,416,447	23.4%
WorldCom	$1,493,416,401	10.8%
Sprint	$363,726,482	2.6%
All Others	$240,251,620	1.7%
World	$13,887,518,127	
Pre-Merger HHI		4,450

Table 5 - Post-Merger International Message Toll Service

AT&T	$8,537,707,177	61.5%
MCI/WorldCom	$4,745,832,848	34.2%
Sprint	$363,726,482	2.6%
All Others	$240,251,620	1.7%
World	$13,887,518,127	
Post-Merger HHI		4,954
Increase in HHI		504

An analysis of specific geographic markets for IMTS paints an even more striking picture. Again, based on the Commission's policy of considering each international route to be a separate geographic market, GTE's analysis shows that the proposed merger would result in significant market overlap. Based on 1995 data, in at least 30 markets where WorldCom's and MCI's IMTS services currently overlap, the merger would be "likely to create or enhance market power." *See* Appendix 3 hereto. These markets include:

- 11 countries in Western Europe
- 4 countries in Asia
- 4 countries in the Caribbean and South America
- 3 countries in the Middle East
- 3 countries in Eastern Europe
- 3 countries in Africa
- 2 countries in the South Pacific

Further, in 12 other markets, a merger between WorldCom and MCI would "raise significant competitive concerns" under the *Merger Guidelines*.[66] In short, the merged entity would have the power and incentive to engage in anti-competitive conduct that would detrimentally affect consumers in the IMTS market.

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66 As in the international private line market, the possibility that carriers could offer service via "transit" arrangements will not alleviate WorldCom/MCI's market power on particular U.S.-foreign routes.

B. The Merged Entity Would Control an Essential Input for Retail Service Providers, Thereby Creating Barriers to Entry for Competitors in the U.S. International Telecommunications Marketplace.

Product market. As the Commission recognized in the *BT/MCI II Order*, the competitive effects of a proposed merger must be assessed for international input (primarily transport) markets as well as for retail markets. The analysis of effects in input markets is important because ultimate consumers may be injured to the extent that producers of final goods pass on higher input costs by raising end-user prices,[67] and because control of scarce facilities will create barriers to entry in the retail market, further entrenching the oligopoly. The international transport market is an essential input for the provision of international voice data and Internet transmission services on a retail basis.[68] As discussed more fully below, WorldCom and MCI are significant participants in the international transport input market – and a merger of the two

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67 *BT/MCI II Order* at ¶¶ 58-60; *see also Bell Atlantic/NYNEX Order* at ¶¶ 115-120.

68 Private line services also constitute an input market under certain circumstances (as well as being a separate retail market, as discussed above). Large, sophisticated businesses and government users must maintain secure and reliable communications and thus cannot use the public switched telephone network ("PSTN") or virtual private networks ("VPN"), which involve some other entity performing network management functions. Examples of such purchasers are the large "closed user groups," such as SWIFT (banking) and ARINC and SITA (airlines). Instead, these users must construct or obtain private networks composed of leased private lines. The proposed merger could severely restrict competition in this input market. (Although the FCC has not specifically examined the issue, European antitrust regulators consider the provision of private lines and bare capacity to sophisticated network providers to be a separate input market.) Specifically, the merged entity could raise the price of private lines, which, in turn, would drive up the costs of banking, aviation, and other services, to the detriment of the public.

companies would create market power and increase barriers to entry for competitive U.S. carriers.

Geographic market. International transport normally is accomplished through underseas cables located in the Atlantic, Pacific and Caribbean Ocean Regions.[69] The most heavily subscribed region is the North Atlantic, which includes routes between the United States and Europe. Accordingly, the initial analysis presented below focuses on the Atlantic region.[70] The Atlantic Region is served by a number of underseas cables owned by consortia of international telecommunications carriers. The existing cables include TAT-8, -9, -10, -11, and -12/13.[71] In addition, two new cables – Gemini (a private cable) and Atlantic Crossing – will soon become available.[72]

Most significant participants. Once again, WorldCom and MCI have supplied no information regarding their respective ownership interests in the Atlantic Region cables or the extent to which spare capacity is available. Nonetheless, the Commission has recognized that, with respect to existing facilities, TAT-12/13 is a reasonable proxy for

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69 Satellite capacity also is used for international transport. However, due to its relatively high cost and quality constraints, satellite service is typically not a provider's first choice for point-to-point transport. *See BT/MCI II Order* at ¶ 80.

70 The Commission should compel the applicants to provide information regarding their ownership shares in all common carrier and private cables in all major oceanic regions.

71 These routes also are served by two private cables (PTAT and CANTAT-3). FCC 1996 Circuit Status for U.S. Facility-Based International Carriers, Table 7 (Dec. 2, 1997).

72 The Commission has authorized construction and operation of several new cable systems, but only Gemini and Atlantic Crossing will be operational in the North Atlantic within the next year. *See BT/MCI II Order* at ¶¶ 101, 141.

concentration in the entire Atlantic Region because it is the most cost-effective, reliable, and largest (with as much capacity as all of the other currently operating cables combined).[73] The data regarding TAT-12/13, as depicted below, reveal substantial cause for concern regarding the potential for anticompetitive conduct in this market. Moreover, these concerns are significantly exacerbated when information regarding the new cables is added into the mix.

With respect to capacity allocation in international cables, analysis of the U.S. side of the cable is the most relevant.[74] As Table 6 shows, allocation of existing U.S.-end international transport capacity (using TAT-12/13 as a proxy) already is concentrated; the pre-merger HHI for capacity allocation on the U.S.-end of the TAT-12/13 is 1907. This figure falls within the "highly concentrated" range of the Department of Justice merger guidelines[75]:

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[73] *See BT/MCI II Order* at ¶¶ 98, 134, 135; TeleGeography 1996/1997, Global Telecommunications Traffic Statistics & Commentary at 61 (Gregory C. Staple ed. 1996/1997).

[74] Traditionally, international capacity has been divided into "half-circuits" owned by entities on each end of a cable. These circuits are then paired to complete a transmission. Were any single carrier, or group of carriers, to control the U.S. side of half-circuit capacity, such entity or entities would be able to exert market power over other carriers. Although the half-circuit model may some day be replaced by "whole circuits," the market for U.S.-side half-circuit capacity remains the most critical input for new carrier entry. In any case, existing whole circuits likely would be covered by half-circuit data.

[75] *See* 1992 Horizontal Merger Guidelines, 57 Fed. Reg. at 41558 § 1.5.

Table 6 - Pre-merger TAT-12/13 U.S.-end MIUS Assignments[76]

[illegible]	[illegible]	[illegible]
AT&T	1298	32
MCI	1131	28
Sprint	275	7
WorldCom	247	6
Others	1081	27
Pre-merger HHI		1907

A merger of WorldCom and MCI would further concentrate an already concentrated market.[77] The merged company would have an 18 percent share of the overall ownership interest in TAT-12/13 (the second highest percentage),[78] and, as Table 7 demonstrates, would have a total U.S.-end circuit allocation of 34 percent (the

[76] The source for the table is the June 1997 TAT-12/13 Schedules. MIUS is a measure of the minimum amount of cable capacity available to a carrier that is an initial purchaser of a cable.

[77] With respect to other cables, GTE has been able to determine that MCI has approximately 18 percent of all of the TAT-11 U.S.-end circuits and approximately 12 percent of all of the TAT-8 U.S.-end circuits allocated to it. WorldCom also has approximately 4 percent of all of the TAT-11 U.S.-end circuits and approximately 13 percent of all of the TAT-8 U.S.-end circuits allocated for its use. The pre-merger HHI for the market for U.S.-end capacity on the TAT-11 and -8 would be 2662 and 4967 respectively. Additionally, the merged company will have allocated to it 26 percent of all of the TAT-11 U.S.-end circuits and 25 percent of all of the TAT-8 U.S.-end circuits. The post-merger HHIs would be 2812 for the TAT-11 U.S.-end circuit market, and 5284 for the TAT-8 U.S.-end circuit market. Thus, the proposed merger would be likely to create or enhance market power under the DOJ/FTC merger guidelines.

[78] WorldCom has approximately 0.8 percent overall capacity ownership in TAT-12/13. *See* June 1997 TAT-12/13 Schedules. This interest, combined with MCI's 16.8 percent overall capacity ownership, would give the merged entity 17.6 percent overall ownership, second only to AT&T with an overall ownership interest of 22.7 percent. *Id.*

highest percentage).[79] The post-merger HHI would be 2251 for the TAT-12/13 U.S.-end circuit market, an increase of 344. Under the Department of Justice's merger guidelines, this increase would be likely to create or facilitate the exercise of market power.[80]

Table 7 - Post-merger TAT-12/13 U.S.-end MIUS Assignments

WorldCom/ MCI	1378	34
AT&T	1298	32
Sprint	275	7
Others	1081	27
Post-merger HHI		2251
Post - merger HHI Delta		344

<u>Adverse competitive effects of the merger</u>. While the immediate increase in concentration from the merger certainly gives rise to serious market power concerns, the near-term effects produce even greater cause for alarm. Although two new high capacity cable systems will be in operation by mid-1998, one (Gemini) is 50 percent owned by WorldCom, and the other (Atlantic Crossing) is reported to be 70 percent pre-

79 *See* Table 7. It bears noting that following a merger, the merged company would have approximately 40 percent of the circuits between the United States and the United Kingdom. Currently, MCI has 496 of the 1674 Green Hill - Land's End circuits allocated for its use; WorldCom has 170 out of the 1674 circuits allocated for its use. *See* June 1997 TAT-12/13 Revised Schedule.

80 *See* Table 7; 1992 Horizontal Merger Guidelines, 57 Fed. Reg. at 41558 § 1.5.

sold, almost certainly to companies with significant existing capacity. As a result, non-owner entrants must obtain capacity on an indefeasible right of user (IRU) basis at potentially increased prices. Thus, if the merger of WorldCom and MCI is approved, capacity on of the four largest trans-Atlantic cable systems would be controlled in large measure by the merged company.

The potential for anti-competitive activity is heightened because there is a shortage of undersea cable capacity. The last two trans-Atlantic cables (TAT-12/13) were completed only recently, but have already sold out their original ownership capacity. Because these new cables are either almost completely spoken for or owned by WorldCom itself, this capacity shortage may persist for some time.

With the increased market power of the merged company in the international transport input market comes the risk of serious anti-competitive activity. In the *BT/MCI II Order*, the Commission cautioned that merged entities with market power in input markets "might be able to raise the price of that input, either unilaterally or through coordinated interaction, which could harm consumers to the extent that, in the absence of regulation in the end-user market, the increased input price would be passed on in the form of higher end-user prices."[81] The Commission also cautioned that "the merged company conceivably could injure competition by discriminating against unaffiliated producers of the end-user service."[82] Such behavior is a very real possibility where, as

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81 *BT/MCI II Order* at ¶ 58.

82 *Id.*

here, the merger would result in substantial control by WorldCom/MCI of U.S.-end underseas cable capacity.

The net result of the merger thus would be increased barriers to entry and higher costs of service for retail U.S. international telecommunications markets. A constrained supply of cable circuits – especially when combined with a restricted supply of private lines, as discussed above – could deprive new entrants of an essential facility required to compete in the marketplace. The Commission's goal of fostering new entry and lower prices in international telecommunications will be frustrated if access to cable circuits is constrained.

The foregoing is especially true given that the entities currently controlling cable circuits are also in the retail business. This suggests that WorldCom/MCI will have the incentive and ability to restrict output (of cable circuits) to prevent competition in the retail market. Indeed, this merger not only creates the risk of unilateral anti-competitive behavior, it also could give rise to joint market power – collusion – among the three large U.S. carriers (WorldCom/MCI, AT&T, and Sprint).

Further, it is conceivable that WorldCom/MCI – by itself or in concert with the two other large carriers – would enjoy market power in the market for "connecting facilities" between the cable landing points and the public switched network. As the Commission recognized in the *BT/MCI II* Order, control of connecting facilities could squeeze existing U.S. carriers and new entrants and reduce price competitiveness.[83] Because the combined entity would possess even more market power than would BT-MCI on the

83 *See BT/MCI II Order* at ¶¶ 295-297 (conditioning approval on commitment to provide access to connecting facilities).

U.S. end of undersea cables – and in U.S. connecting facilities – the risks of such conduct are far greater.

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WorldCom and MCI have supplied no data to support their claims that the merger of the two companies will increase competition in the international telecommunications market. In fact, using publicly available data, it is apparent that the merged entity will assume a dominant position in the retail IMTS and private line markets. Moreover, through its ownership of cable circuits, the combined entity also will control an essential input – cable capacity – needed by new entrants to compete on a retail level. Because a merger of WorldCom and MCI would constrain competition in U.S. international telecommunications markets, both retail and wholesale, the FCC should deny the transfer applications.

IV. WORLDCOM HAS FAILED TO ADDRESS THE COMPETITIVE EFFECTS OF THE MERGER ON LOCAL EXCHANGE AND EXCHANGE ACCESS SERVICES.

The applicants allege that one of the proposed merger's overarching benefits is that the combined MCI-WorldCom's "greater resources, synergies and efficiencies" will permit "more aggressive" competition in local exchange markets than either company could achieve individually.[84] To support this conclusion, the application makes much of the fact that MCI-WorldCom will have "local facilities in over 100 markets."[85] The applicants further allege that, when WorldCom's local facilities are combined with MCI's

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[84] Application at 2, 7.

[85] *Id.* at 2.